FILE COPY

Office - Supreme Court, U. S.
FILED
MAR 19 1948
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 684

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

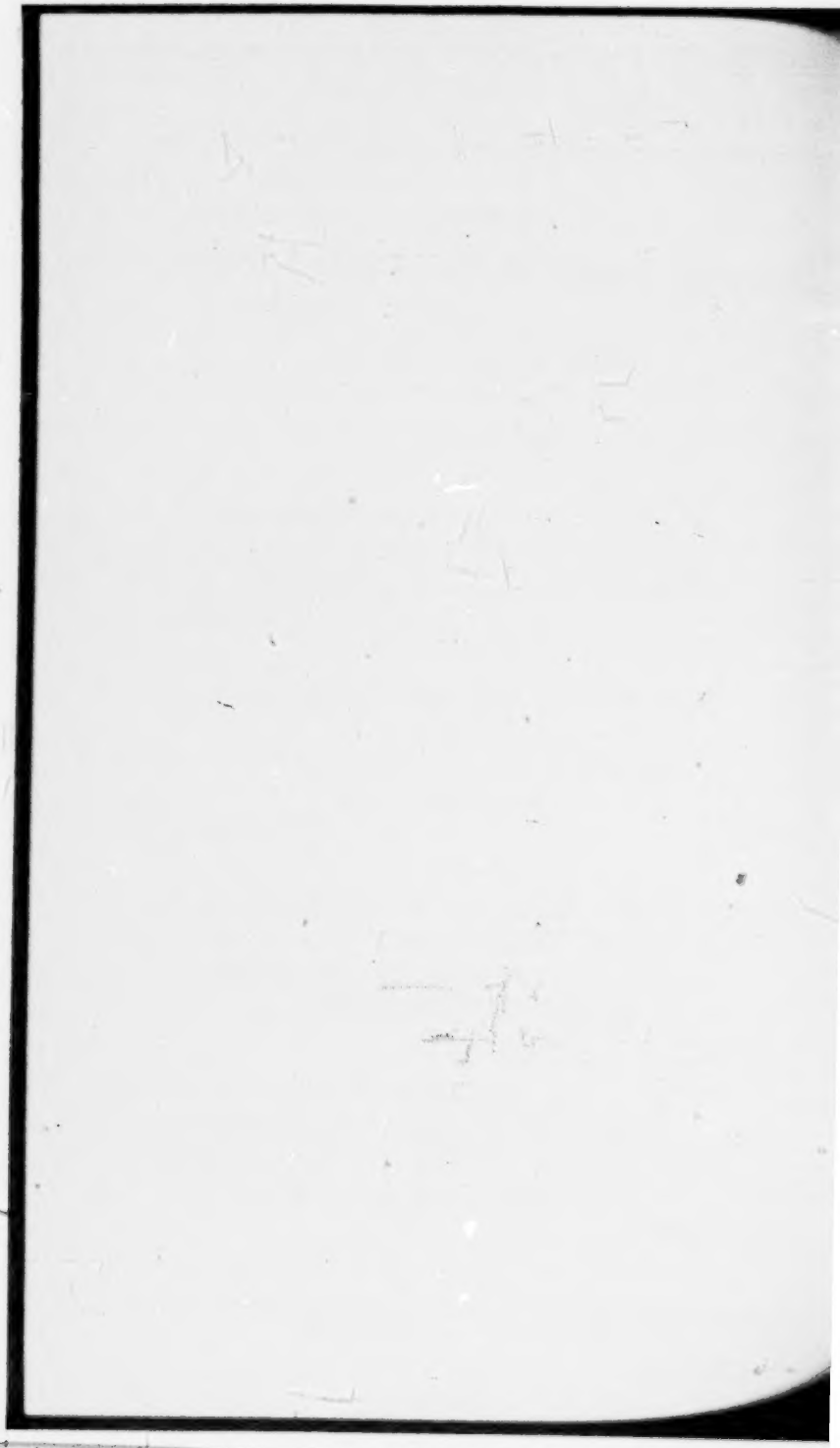
A. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

March 19, 1948.

The Daily Record Co., Baltimore 3, Md.



INDEX

	PAGE
PETITION FOR WRIT OF CERTIORARI:	
OPINIONS OF THE COURTS BELOW	2
JURISDICTIONAL STATEMENT	2
STATUTES INVOLVED	2-3
SUMMARY STATEMENT OF THE CASE (including outline of facts)	3-6
NATURE OF THE PROCEEDINGS BELOW	7
THE QUESTIONS PRESENTED	8
REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT	9-10
CONCLUSION	11
BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI:	
INTRODUCTORY (including comment on facts)	1-5
ARGUMENT	5-16
First Point: Alleged "compromise" an illusion	5
Second Point: Guarantors obtained a voidable preference, as defined by 1938 Bankruptcy (Chandler) Act:	
a. Guarantors are Creditors	7
b. Banks' Right of Set-Off	7-10
c. The Chandler Act (1938)	10-13
d. Equality is Equity	13
e. Guarantors Received a Preference	14-16
CONCLUSION	16

Table of Cases

[Key: (P)=Petition; (B)=Brief]

PAGE

Bank vs. Massey, 192 U. S. 138 ..... (B) 5, 9
Citizens Nat. Bank of Gastonia, N. C. vs. Lineberger, 45 F. (2d) 522 ..... (B) 11, 12, 16
Drugan vs. Crabtree, 299 F. 115 ..... (B) 11, 16
Goldman vs. Cohen, 1 Cir., 250 F. 599 ..... (B) 7, 15
Paper vs. Stern, 198 F. 642 ..... (B) 7, (P) 10
Sampsell vs. Imperial Paper Corporation, 313 U. S. 215 at 219 ..... (B) 13
Schleicher Printing Corp., 62 F. (2d) 503 ..... (B) 7, (P) 10, (B) 14
Swarts vs. Siegel, 117 Fed. 1, 13 ..... (B) 15
U. S. Bank vs. Chase Bank, 331 U. S. 28 ..... (B) 13
Walker vs. Wilkinson, 3 F. (2d) 867 ..... (P) 10, (B) 14

Table of Statutes and Other Authorities

U. S. C. A., Title 11, Sec. 1 (25)—Definition of "transfer"—prior to 1938 ..... (P) 2, 3
U. S. C. A., Title 11, Sec. 1 (30)—Definition of "transfer"—since 1938 ..... (P) 2, 10
U. S. C. A., Title 11, Sec. 47c ..... (P) 2
U. S. C. A., Title 11, Sec. 96 (Sec. 60 of Bankruptcy Act—Preferences) ..... (P) 2, (B) 7, 8, 9, 10
U. S. C. A., Title 11, Sec. 108 (Sec. 68 of the Bankruptcy Act—Set-Off) ..... (B) 7, 8, 9, 10
U. S. C. A., Title 28, Sec. 347 (240 (a) of the Judicial Code) ..... (P) 2
U. S. C. A., Title 41, Sec. 15 (1940 Act: Assignment of Claims) ..... (P) 5
Collier on Bankruptcy, 14th Edition, Secs. 60.15 and 60.17, Vol. 3, p. 811 ..... (B) 7, 12, 15
Collier on Bankruptcy, 14th Edition, Sec. 68.01, Vol. 4, p. 705 ..... (B) 12
Glenn, (2), Fraudulent Conveyance and Preferences, 1940, Secs. 460-462 ..... (B) 7

PAGE

Weinstein, The Bankruptcy Law of 1938—Chandler Act, Commentary by Author ..... (B) 10, 11

Weinstein, The Bankruptcy Law of 1938—Chandler Act, Foreword by Sponsor of Chandler Act ..... (B) 10

INDEX TO RECORD

Petition of Trustee for approval of settlement 1-6

Attached Exhibit No. 1 from Baltimore National Bank, First National Bank and the Messrs. Cummins 6-9

Attached Exhibit No. 2, Letter to Trustee from Baltimore National Bank 10-11

Attached Exhibit No. 3, Trustee's acknowledgment of receipt of offer of settlement 11-12

Order of Referee ratifying nisi proposed settlement 12-14

Final order of Referee ratifying settlement 14-15

Creditors' petition to review Referee's order 15-17

Referee's finds of fact and conclusions of law 17-19

Trustee's exception to claim of Baltimore National Bank (Recipient under old assignment of contract) 20

Testimony and statements produced at hearing before Referee 20-45

Note: Including statements of counsel for Trustee and creditors and for the Baltimore National Bank as presented at the Referee's hearing.

Trustee's Exhibit No. 5, Sheet 6, (Bankrupt's $10,000.00 note to Baltimore National Bank) 45-46

Trustee's Exhibit No. 5, Sheet 7 (Bankrupt's note for $25,000.00 to Baltimore National Bank) 46-47

Trustee's Exhibit No. 5, Sheet 8 (Bankrupt's $35,000.00 note to Baltimore National Bank) 48-49

PAGE

Trustee's Exhibit No. 7 (Letter of December 8, 1944, from one of guarantors to Baltimore National Bank and First National Bank settling remaining liability of guarantors to said banks) 49-50

Trustee's Exhibit No. 8 (Letter of the Banks of December 8, 1944 to the Guarantors) 51-52

Loan agreement between Bankrupt and its joint venturer with the Baltimore National Bank and the Guaranty Trust Company of New York dated December 17, 1942 52-55

Opinion of the District Court (Hon. William C. Coleman) 55-70

Order of Court (June 5, 1947) ratifying agreement of proposed settlement with modification requiring payment of interest by Baltimore National Bank 70-71

Consent of the Banks and of the Guarantors to the Court's modification requiring interest payment 71-72

Abstract from "Designation of Contents of Record on Appeal" on appeal to Circuit Court of Appeals 73

Statement of Points on appeal to the Circuit Court of Appeals 75-76

Testimony taken before Referee on June 4, 1946 76-122

Proceedings in the Circuit Court of Appeals 123

Opinion of the Circuit Court of Appeals 124-132

Judgment and Order of the Circuit Court of Appeals, December 22, 1947 133

Stipulation between counsel as to contents of record for the purpose of petition for Writ of Certiorari 134

Certificate of Clerk of Circuit Court of Appeals 135

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. ------

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

A. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

TO THE HONORABLE: THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitioners respectfully pray that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Fourth Circuit, to review the Order and Judgment of that Court entered on December 22nd, 1947 (R. 133), which affirmed an order of the United States District Court for the District of Maryland entered on June 5th, 1947 (R. 70, 71).

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Fourth Circuit appears in the Record at pages 124 to 132, and is reported in 164 Fed. (2) 983.

The opinion of the District Court for the District of Maryland appears in the Record at pages 55 to 70, and is reported in 72 Fed. (S) 409.

JURISDICTIONAL STATEMENT.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended (28 U. S. C. A. Sec. 347) and Section 24 (c) of the Bankruptcy Act (11 U. S. C. A. Sec. 47 c), agreeably to Rule 38 of this Court.

STATUTES INVOLVED.

52 Stat. 869, 11 U. S. C. A. Sec. 96 (1943).

> "Sec. 60. Preferred Creditors.—a. A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy * * *, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class; * * *".
>
> "b. Any such preference may be avoided by the Trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when such transfer is made, reasonable cause to believe that the debtor is insolvent."

The term *"transfer"* as now used in the Act, its scope and meaning are particularly defined by Section 1 (30) of U. S. C. A., Title 11. This definition was first incorporated by the Chandler Act (in 1938) and is considerably ex-

panded over that previously employed in the Bankruptcy Act (Sec. 1 (25) of U. S. C. A., Title 11)—prior to the 1938 amendment.

Now, and since 1938, the term *"transfer"*, as used in the aforegoing section 60 of the Act:

> "shall include the sale and every other and different mode, *direct or indict*, of disposing of or parting with property *or with an interest therein* or *with* the possession *thereof or of fixing a lien upon property or upon an interest therein*, absolutely or conditionally, *voluntarily or involuntarily, by or without judicial proceedings*, as a *conveyance, sale, assignment*, payment, mortgage, *lien, encumbrance*, gift, *security or otherwise.*" (Italics supplied, see below.)

By contrast the earlier definition read so as to provide only that:

> " 'Transfer' shall include the sale and every other and different mode of disposing of or parting with property, or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift or security."

To render in sharper contrast the added scope and coverage in the definition of the term *"transfer"* accomplished by the 1938 amendment over the earlier definition, which controlled decisions of the Courts prior to 1938, we have italicized above so much of the *1938 definition* as did not appear in the Bankruptcy Act prior to the Chandler amendment.

SUMMARY STATEMENT OF THE CASE.

The pivotal matters of facts here involved are so free of dispute as to be virtually stipulated.

The bankrupt had been engaged in the construction industry; for months prior to its adjudication on January

4th, 1945, it had ceased to function as an active and going concern; it had been long pressed by its outstanding creditors for payment (claims have been filed in excess of $410,000); a large Government construction contract had been earlier terminated; its officers, directors and stockholders (Messrs. Charles, Harold, John and Albert Cummins) had guaranteed its obligations to two Baltimore banks, represented by notes of the Corporation to such Banks for loans previously advanced.

With knowledge of the right of the two Banks to apply or set-off any balances in bank in reduction of the corporation's outstanding note obligations held by such Banks (which application would reduce the individual liability of the Messrs. Cummins as guarantors) the Officers (Guarantors also) continued in the weeks prior to October 16th, 1944, to make deposits of corporate funds in such Banks, though they also maintained a third depositary, to which Bank the Company was not indebted (R. 32).

On October 16th, 1944, shortly after a visit to both Banks by one of the Guarantors (i.e., Officers of the Bankrupt) by which date it was fully evident that the Corporation was knowingly insolvent, both Banks applied the Bankrupt's cash balances on deposit with them, in an amount in excess of $68,500, in reduction of such outstanding note claims of the Banks against the Bankrupt, upon which the Messers. Cummins were individually and unqualifiedly liable as guarantors.

On December 6th, 1944 (nearly two months after the above occurrences and within one month of the Bankrupts adjudication) one of those Banks (R. 3) under the circumstances next recited, received $45,103.73 under an old and inadvertently unrevoked assignment of funds to accrue under a Government contract, one half of which

($22,551.86) such Bank then sought to apply to the old balances still due upon the aforementioned notes of the Bankrupt, guaranteed by the Messrs. Cummins (R. 4).

The circumstances under which such Bank received those funds are:

(a) In 1942 when the Bankrupt and a co-venturer were awarded a large government construction contract (later terminated by the Government), the joint venturers made arrangements with this Baltimore bank to act as Agent for itself and a New York bank in loans to be made to the joint venturers by both banks (in proportions of one-sixth and five-sixths up to a maximum of $3,000,000) for use exclusively in the financing of the cost of construction of such joint contract (R. 52-55).

(b) At that time (1942) an assignment was executed (under the Assignment of Claims Act, Title 41 U. S. C. A. Sec. 15-1940) by the joint venturers to the Baltimore bank, as agent, by which sums payable under the joint contract would be paid to the Baltimore bank, as agent, *only* to secure repayment of the unpaid loans to be made by the Banks to the joint venturers for use *only* in the joint undertaking;

(c) Though all loans ever advanced under this arrangement had been admittedly fully repaid, and the period during which the Banks could make any such loans had long before elapsed (the agreement specifically provided that no such loans could be made after December 31st, 1943—R. 54) the joint venturers had neglected to formally revoke the assignment;

(d) It thus resulted that the Baltimore bank, as assignee-agent under the unrevoked assignment, received a Government check on December 6th, 1944 for $45,103.73, one half

of which it immediately delivered to the other joint venturer and one half ($22,551.86) it undertook then to apply against the remaining unpaid balances owing to it upon such old notes of the Bankrupt, guaranteed by the Messrs. Cummins.

In August, 1946 the Trustee requested approval of an alleged "compromise and settlement" by the terms of which:

(a) The Bankrupt estate would waive any claim, against the two Baltimore banks, that the application of the cash balances of some $68,500 on account of the Bankrupt's note indebtedness constituted a preference;

(b) The one Baltimore bank (which as assignee under the extinct though formally unrevoked assignment had obtained the Government payment of $45,103.73 on December 8th, 1944) would return to the Bankrupt estate $22,551.86 (being one half of such sum) which it had received under the circumstances hereinabove recited and had, within one month of adjudication, undertaken to apply to the old debts of the Bankrupt;

(c) The Bankrupt estate would then, in consideration only of such return (b), release any claims assertable against the Guarantors (Messrs. Cummins) who, within the four month period had thus obtained a $68,500 benefit (by reason of reduction of their liability as guarantors in that amount) when the two Baltimore banks applied the balances on deposit with them in reduction of the Bankrupt's indebtedness to such Banks.

Numerous creditors opposed such alleged compromise, in behalf of whom these Petitioners are acting.

NATURE OF THE PROCEEDINGS BELOW.

The Referee approved the alleged compromise.

On petition to review the Referee's Order the District Court, in effect, ruled:

(a) That under no theory could the Baltimore bank, which, as assignee, received the aforementioned $22,551.86, retain that collection;

(b) That such Bank must return such sum to the Trustee, and for its failure to do so sooner, it must in addition pay interest thereon;

(c) That although the Trustee could under all circumstances recover this sum, with interest, and though nothing more was offered as a consideration therefor, the Trustee was directed also to release the guarantors in the release to be executed in favor of the Banks by the Trustee.

On appeal the Circuit Court, in affirming, in effect, ruled:

(a) That the Baltimore bank, as such assignee, could under no circumstances retain such collection, and must therefore return that sum with interest to the Trustee;

(b) That though the guarantors are considered to be "*creditors*" within the meaning of the Bankruptcy law, and though within four months of the adjudication, with a knowledge of the Bankrupt's insolvency, obtained a *benefit* (when the Banks applied the balances on the note indebtedness guaranteed by them) by the reduction of their outstanding liability, a voidable preference did not result. The Circuit Court, observing that since an undecided question was here first presented, under the 1938 Chandler Act, ruled that, despite the enlarged meaning of "transfer" that term was still to be construed as it had been prior to 1938.

QUESTIONS PRESENTED.

I.

Where it is conceded that only the sum of money admittedly recoverable under any circumstances from the Baltimore bank is offered to the Trustee, should the Trustee, without any further consideration whatsoever, extend a release from the estate to four solvent, individual guarantors against whom the estate has (at the very least) a colorable claim for $68,500?

II.

Under section 60 of the Bankruptcy Act, regardless of the statutory right of set-off (permitted by section 68 between those having mutual debts or credits) allowed to the Baltimore banks, by which they applied the Bankrupt's balances in reduction of the note indebtedness, did not the guarantors, by reason of the enlarged scope and meaning of "transfer" enacted by the Chandler Amendment in 1938, obtain a benefit, which is a voidable preference?

III.

That since there is (at the very least) a colorable and prima facie claim against those four solvent guarantors for the benefit of the Bankrupt estate exceeding $68,500 (to recover which the objecting creditors have, with the consent of the lower Court, instituted action at their own expense but for the benefit of the estate), the Trustee should not, without any consideration whatever, be allowed to release the guarantors from such liability as the pending plenary action may establish.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.

1. The Circuit Court of Appeals for the Fourt Circuit has decided a question of Federal law of substantial and far reaching importance in the administration of the bankruptcy laws, which has not heretofore been presented or settled, but which should now be finally settled by this Court, to-wit:

(a) If a guarantor is a creditor within the purview of the Bankruptcy law, as is admitted by all parties, and accepted by the lower Courts in this case; and

(b) If such creditor, with knowledge of his own corporation's insolvency, within four months of its adjudication, receives a *"preference"* by which he benefits in consequence of the reduction of his guarantor's liability, as is admitted by the parties, and accepted by the lower Courts in this case; and

(c) If a *"preference"* is declared by section 60 of the new Act to be a *"transfer"*, which is expressly defined by section 1 (30) to include "the sale and *every other and different mode, direct or indirect,* * * * *of parting with property or with an interest therein* or *with the possession thereof* or *of fixing a lien upon property* or *upon an interest therein*, absolutely or conditionally, *voluntarily or involuntarily, by or without* judicial proceedings, *as a* * * * *payment*, * * *, *lien, encumbrance*, * * *, *security* or *otherwise"*, (Italics supplied), then:

(d) Has not such creditor (guarantor) as a matter of law obtained a voidable *preference*, under the *present* as distinguished from the *prior* Bankruptcy Act, when the Bankrupt's depositaries apply its bank balances upon such guaranteed note obligations?

Stated differently does not such application of funds by the Bank (called *set-off* under section 68 of the Act) represent in law:

(a) either an *indirect* or *involuntary*, or *some other or different mode*, of *"parting with property"*, or *"with an interest therein"* (i.e., the insolvents right to withdraw such balance by check or draft), "without judicial proceeding", or similarly;

(b) either *indirectly* or *involuntarily*, *"fixing a lien upon property or upon an interest therein, absolutely or conditionally"*, "without judicial proceeding", as "security or otherwise".

The opinion of the Circuit Court below, in this case, observed that the question projected here, has not been considered in any other case (R. 132).

2. It is essential that section 60, as amended in 1938 by the Chandler Act, and the meaning to be accorded to the term *"transfer"* in the greatly broadened scope and significance attributed to it by the new definition thereof adopted by the Chandler Act (section 1 (30)), be uniformly and authoritatively construed and applied throughout the United States for the guidance of all of the Courts.

3. The practical effect of the decision in this case is in conflict with the rationale of decisions in the 5th Circuit, (Walker vs. Wilkinson, 3 F. (2) 867 at 871), in the 2nd Circuit (Re: Schleicher Printing Corp., 62 F. (2) 503 at 504), and in the 8th Circuit (Paper vs. Stern, 198 Fed. 642), which were decided prior to and without aid of the expanded meaning of the term "transfer", upon the meaning and construction to be attributed to which term, under the Chandler Act of 1938, depend innumerable questions of law of constant and grave importance in the Courts. And which questions are currently receiving consideration in Congress.

CONCLUSION.

Wherefore your Petitioners respectfully pray that a writ of certiorari be issued under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fourth Circuit to review the order and judgment of that Court in the above cause; and that said Order and judgment be reversed; and that your Petitioners be granted such other and further relief as may seem proper.

Respectfully submitted,

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

March 19, 1948.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. ------

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

A. RAYMOND MACHEN, TRUSTEE
in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

INTRODUCTORY.

I.

Reasonable comment would appear to warrant at least a passing reference to the strange position of the Trustee in Bankruptcy in this cause.

As both the District Court and the Circuit Court have declared that recovery from the Baltimore Bank, Assignee under the unenforcable though formally unrevoked assignment, of the $22,551.86 could not be denied, and as no

additional consideration whatsoever is received by the Trustee, it is difficult to appreciate the Trustee's insistence that this so-called "compromise and settlement" be consummated in order that the Guarantors be relieved of the necessity of responding to the claim that they have derived an avoidable preference in the amount of $68,500.00.

The Trustee, a close personal friend and sometime business associate of the Guarantors, cannot suggest that prosecution of the preference claim against the Guarantors might subject the bankrupt estate to needless cost and expense, since the objecting creditors, with the consent of the District Court, and at their own cost and expense (but for the benefit of the estate generally) have already filed and now have pending a plenary action against the Guarantors in respect of those claims. Ordinarily it would be expected that a Trustee in bankruptcy would not be so zealous as to come to the aid of challenged recipients of preferences.

It is an almost irresistible conclusion, drawn from the above, that the Trustee in this case in seeking, without possible gain to the estate, to free the Guarantors from the necessity otherwise of responding in the pending plenary actions filed against them, is indeed appearing for the Guarantors.

As the Circuit Court of Appeals said, and this statement will be helpful here in more readily defining the precise issue (R. 127):

> "The area of discussion will be much reduced if the position of the parties on certain questions, once at issue, but now in effect removed from the field of controversy, is first stated. The Trustee in bankruptcy although inclined at first to the opinion that reasonable argument, based largely upon the breadth of certain provisions in the collateral notes held by the Balti-

more National Bank, could be set up in support of the Bank's claim to the proceeds of the Government check, is now satisfied that the claim cannot be sustained. Furthermore, it is not now disputed that on October 16, 1944, when the banks took over the deposits, both they and the endorsers had reasonable ground to believe that the Construction Company was insolvent."

It would thus appear that the legal questions involved, important here and generally so in the administration uniformly ~~of the administration~~ of the Bankruptcy Act, present for determination authoritatively and finally a hitherto undecided and unsettled proposition of law.

But first, can the proposal, endorsed by the Trustee, which adds nothing to the estate beyond what is his for the mere request, be legally approved simply because it is termed a "compromise and settlement"? We ask: What are the Guarantors paying for this alleged compromise by the estate of a $68,500.000 claim against them? The answer, and it is the answer of both the District Court and the Circuit Court below, is: Nothing. Can any such arrangement, thus artificially and incorrectly designated, ever be anything more than what it is: a pure gift, by way of a full release without consideration of any kind, to the Guarantors?

The other and the far reaching legal proposition involves a fundamental interpretation of one of the basic sections of the entire Bankruptcy Act. It is a question which is novel and unique and not yet ruled upon by this Court. Do not the Guarantors (officers, directors or stockholders of a family corporation) receive a voidable preference when, with all of the ingredients otherwise requisite to such a holding present, they obtain or receive a $68,500.00 benefit (by reduction in that amount of their Guarantor's

liability to the banks) upon the application or set-off by the banks of the insolvent's cash balances against the note indebtedness of the corporation to the banks?

It is submitted that now, and since the 1938 Chandler Amendment, unlike the state of the law as it existed theretofore (which depended upon the earlier and narrow definition of the term "transfer"), such set-off by the bank is a preference in favor of the Guarantors, since the present act characterizes the term "transfer", for the purposes of identifying *preferences*, as including even the *involuntary*, the *indirect* and *every other and different* mode, whether with or *without judicial proceeding*, by which property or an *interest therein* or the possession thereof is changed (i.e., disposed of or parted with).

It has been observed that the earlier definition of the term "transfer" contained no reference to either of the signficant amendatory enlargements in the new definition, viz: an indirect or an involuntary or a non-judicial parting with an interest in property.

The petitioners most respectfully urge that when a depositary, holding bank balances credited and belonging to a customer, acts to apply or to set-off such balances against an indebtedness owing to it by such customer, that this act of the bank constitutes at least the involuntary parting, even though indirectly so, with an interest in property. Since 1938, any such parting with an interest in property is clearly and literally condemned where it benefits a creditor or guarantor) inasmuch as even "involuntary" or "indirect" acts or occurrences are comprehended by the express terms of the Bankruptcy Act.

Can it be soundly argued, as the respondent must here, that the right of the depositor in the bank balances held by his depositary—whether it be nothing more than a

chose in action—is not "an interest in property"? Entitled to be thus characterized is there not, when the bank so acts, at least an indirect or involuntary parting with such an interest in property, on the part of or away from the depositor?

See: N. Y. County Bk. v. Massey, 192 U. S. 138 at 145.

II.

The petitioners are not unmindful that the sheer bulk of applications for Writs of Certiorari imposes restriction upon the number and the nature granted. Nor are they unaware that the "open sesame!" into the realm of the Court is more ordinarily found in the statement that there is a conflict between the decisions of the Circuit Courts on a question. The petitioners respectfully submit that, although there is no precise ruling elsewhere upon the second question projected there is, in effect, a conflict in respect of the principles involved already apparent in the Circuit Courts. Moreover it is further respectfully submitted that the importance of the question and the opportunity to settle it finally merits an authoritative ruling by this Court in this case.

III.

ARGUMENT.

The matters set forth in the aforegoing petition are hereby adopted and respectfully made a part of this brief.

First Point.

Where it is conceded that only the sum of money admittedly recoverable under any circumstances from the Baltimore bank is offered to the Trustee, should the Trustee, without any further consideration whatsoever, extend a

release from the estate to four solvent, individual guarantors against whom the estate has (at the very least) a colorable claim for $68,500.?

The petitioners respectfully maintain that the outline of the proposition permits of only one answer.

The Trustee argues that the answer is: Yes.

The petitioning creditors contend that it is: No.

And referring to the introductory section of this brief and obeying the admonition of Rule 38 your petitioners limit discussion on this proposition thereto.

SECOND POINT.

A.

Under Section 60 of the Bankruptcy Act, regardless of the statutory right of set-off (permitted by Section 68 between those having mutual debts or credits) allowed to the Baltimore banks, by which they applied the Bankrupt's balances in reduction of the note indebtedness, did not the guarantors, by reason of the enlarged scope and meaning of "transfer" enacted by the Chandler Amendment in 1938, obtain a benefit which is a voidable preference?

B.

That since there is (at the very least) a colorable and prima facie claim against those four solvent guarantors for the benefit of the Bankrupt estate exceeding $68,000 (to recover which the objecting creditors have, with the consent of the Court, instituted action at their own expense but for the benefit of the estate) the Trustee should not, without any consideration at all, be allowed to release the guarantors from such liability as the pending plenary action may establish.

As these questions are essentially counterparts of the more basic issue presented for determination they are grouped here for ease of discussion.

Guarantors Are Creditors.

The District Court and the Circuit Court are agreed that Guarantors are deemed to be creditors within the meaning of the Bankruptcy Act (R. 65 and 131) for as the Eighth Circuit in Paper vs. Stern, 198 F. 642 long ago announced:

> "* * * The rule, however, is too well settled, and the reasons for it have been too often and too clearly stated, to warrant further discussion, that a guarantor, an endorser, an accommodation maker, or a surety on the obligation of a bankrupt is a creditor within the meaning of Sec. 60b of the Bankruptcy Act. * * *."

To the same effect are:

Cohen v. Goldman, 1 Cir., 250 F. 599;
In Re: Schleicher Printing Corp., 62 F. (2d) 503;
Collier on Bankruptcy, 14th Ed. Sec. 60.17;
2 Glenn, Fraudulent Conveyances and Preferences, 1940, Sections 460 to 462.

Banks' Right of Set-Off.

The right of the banks to apply or to set-off the balances arises *solely* by virtue of Section 68 of the Bankruptcy Act (USCA, Title 11, Sec. 108) and is wholly unconnected with and unrelated to Section 60 of the Bankruptcy Act (Section 96 of Title 11 of USCA) which condemns preferences and authorizes their avoidance by the Trustee.

The petitioners do not contend that the action of the banks on October 16, 1944, in acting to set off the balances in their respective banks against the bankrupt's note indebtedness, *insofar as those banks are concerned*, constituted an avoidable preference (R. 26).

But this result follows, not from any consideration of the provisions of Section 60 but, solely from the right of set-off conferred by Section 68.

Section 68 however applies exclusively between a bankrupt and a creditor having between them mutual debts or mutual credits. And in the absence of such debts or credits there is no right of set-off, even between a creditor and a debtor.

Section 68 provides:

> "Set-Offs and Counterclaims. (a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

The respondent contends that since the action of the banks in "setting-off" the balances against the bankrupt's obligations were not preferences to the Banks, that it follows as an inevitable and necessary corollary that the benefits obtained by the Guarantors as a result of the reduction of their liability is also not a preference.

The petitioners earnestly submit that the act of the banks is saved only and exclusively by the effect of Section 68 of the Bankruptcy Act, which permits the set-off, but limits it alone to *certain creditors*.

But since the Guarantors are not embraced in the class of creditors permitted a set-off by the terms of Section 68, it is accordingly submitted, that such Guarantors are not saved from the direct condemnation of Section 60 for they cannot escape by resorting to the insulation afforded only to the banks by Section 68.

It would appear clear, it seems to us, that without the protection afforded by Section 68 to the banks, that they

too would have obtained a preference within the meaning of the new Bankruptcy Act.

But in any event the Guarantors, having no recourse to the right of set-off created by Section 68—since they do not qualify as creditors holding the requisite claim at that time against the bankrupt—must defend entirely under the provisions of Section 60. Since, as we have observed, the present meaning of the term "transfer" embraces every conceivable occurrence by which any property, or any interest therein or right to possession thereof, is either voluntarily or involuntarily, directly or indirectly parted with, the Guarantors must be said to have received a preference.

The learned Courts below, in substance, have ruled that since the act of the banks in "setting-off" the bankrupt's balances cannot be said to constitute a preference in respect of the Banks themselves (which is so only because of Section 68), that the Guarantors of such obligations are also protected, somehow, by Section 68 (under which however they do not qualify as the kind of creditor entitled to the benefit afforded by the Section by way of set-off).

The petitioners most respectfully submit that such ruling is erroneous.

As announced, in reverse, by this Court in the case of Bank vs. Massey, 192 U. S. 138 at 147 in dealing with the matter there before this Court:

> "* * * But this does not, in our opinion, operate to enlarge the scope of the Statute defining preferences so as to prevent set off in cases coming within the terms of Section 68a. If this argument were to prevail, it would in cases of insolvency defeat the right of set off recognized and enforced in the law, as every creditor of the bankrupt holding a claim against the estate

subject to reduction to the full amount of a debt due the bankrupt receives a preference in the fact that to the extent of the set off he is paid in full."

Paraphrasing that pronouncement, the petitioners contend that Section 68 does not operate to restrict the scope of Section 60 so as to relieve against preferences in cases coming within the terms of Section 60 and in respect of creditors who are not entitled to the direct right of set-off afforded only by Section 68.

We respectfully submit that the obvious benefits received by the Guarantors in this case (passing for the moment the additional fact that they were officers, directors or stockholders of the bankrupt), unprotected and not covered by the provisions of Section 68, are nothing less than a voidable preference under Section 60.

The Chandler Act.

By its adoption in 1938 Congress following prolonged study drastically revised and amended the then existing Bankruptcy law. The changes made were not haphazardly or unwittingly accomplished. Those changes were studiously intended.

In his foreword to the volume "The Bankruptcy Law of 1938—Chandler Act", authored by Jacob Weinstein and prepared for the National Association of Credit Men, Honorable Walter Chandler, M. C. and Sponsor of the Act, declared:

> "Every section of the Act of 1898 was analyzed, and the applicable decisions of construction were reweighed in the light of rapid and far-reaching economic and social changes. Consequently, the amendments to the first seventy-two sections are the result of clear proof of defects and inadequacies."

And the author of the volume in his commentary on page 7 says:

> "This definition, '(25)' of the old Act, has been retained in the Chandler Act, but has been amplified to make it clear that the term 'transfer', as used in the Act, covers every conceivable form or method of transfer of property, interest therein or the possession thereof. * * *"

The Circuit Court below felt impelled to adhere to its earlier rulings, all made prior to the 1938 amendment, in the cases of Citizens' Nat. Bank of Gastonia, N. C. v. Lineberger, 45 F. 2d 522, 527 and Drugan v. Crabtree, 299 F. 115, 119-120.

Those cases were decided at a time when the Bankruptcy Act could not reach benefits received by creditors as a result of either *indirect* or *involuntary* parting or separation from interests in property, which was first permitted and indeed required by the Chandler Act of 1938.

It is interesting to observe that notwithstanding the limitations inherent in the earlier Act one of the Circuit Court Judges in a dissent to Citizens National Bank vs. Lineberger, supra, at page 532 said:

> "* * * The result of the seizure of the deposits in the Bank, when negotiations for a settlement failed, was undoubtedly a preference to these solvent endorsers and not to the Bank * * * The result was that assets of the Bankrupt Company were used to pay debts for which Kirby and Warren (the guarantors in the case) were liable, and the assets of the Bankrupt were diminished in the amount * * *."

The Circuit Court in this cause ruled, after agreeing with the petitioners' contention that the Trustee in Bankruptcy was receiving nothing whatever for the release to the Banks and to the Guarantors beyond what the Trustee was

entitled to receive from the Banks alone, that the term "transfer" although broadened by the 1938 amendment, is, in respect of one class of creditors (i.e. guarantors of bank held obligations), yet to be construed as if it had not been so broadened. The Court, as the predicate for such construction, refers (R. p. 132) to the legislative history of the Chandler Act in respect not of Section 60 (preferences) but that of Section 68 (Set-Off).

The Circuit Court apparently reached its final conclusion because amendments which were offered in Congress to the set-off provision in Section 68 of the Act and which would have altered the recognized rule with regard to the right of set-off failed to secure adoption; the Circuit Court then added:

> "* * *; and that although these amendments received considerable support, they were rejected by Congress; and hence it is clear that although the term 'transfer' has a wider significance as used in Section 60 than formerly, Congress had no intention of altering the accepted law as to bank deposits. * * *" (R. 132).

The Circuit Court cites Collier on Bankruptcy (14th Ed.), (as authority for this conclusion as to the legislative intent), Vol. 4, Sec. 68.01, p. 705 (R. 132), see also: Collier, Vol. 3, Sec. 60.15, pp. 805-806).

It will appear by reference to such citations that the suggested modifications which Congress did not finally accept related alone to and dealt entirely with the matter of restricting the rights of *Banks* to set-off under certain circumstances. The amendments thus proposed to Section 68 intended (by such amendments) to eliminate the right of Banks to obtain or achieve set-offs *for themselves.*

The proposed amendments to Section 68 consequently had no bearing upon Section 60, the effect of which in the

future characterization of "preferences" (or "transfers") was drastically and significantly *enlarged* by reason of the expanded definition of "transfer", then incorporated.

The learned Circuit Court, it is respectfully submitted, veered toward its final decision because of its conclusion that the failure of Congress to adopt the proposed amendments in respect of Section 68, the effect of the adoption of which would have only meant that Banks under certain circumstances could lose their right of set-off, nullified the affirmative action of Congress in distinctly and sharply enlarging the impact of Section 60. This we respectfully submit is erroneous. There admittedly was a legislative change made in the scope of Section 60, which calls for consequent change in its construction.

Equality Is Equity.

This Court has repeatedly declared that Courts of Bankruptcy are essentially Courts of Equity (see the very recent language of Mr. Justice Murphy in United States Bank vs. Chase Bank, 331 U. S. 28 at 36). And that creditors in the Bankruptcy Courts are to receive an equality of treatment, and distribution (Sampsell vs. Imperial Paper Corp., 313 U. S. 215 at 219).

Yet, the effect of the ruling below is to disrupt that equality of treatment and to favor one class of creditor at the expense of another. Since the Guarantors involved in this cause are creditors within the meaning of the Bankruptcy Law along with all other Guarantors, endorsers or sureties, they ought to have no greater right than is afforded under the new Bankruptcy Act to Guarantors of species of obligations other than a bankrupt's indebtedness to a bank.

Guarantors Received A Preference.

There have been many cases in which endorsers or guarantors, even without knowledge of the bankrupt's payment on account of the guaranteed obligation, have been held to have obtained preferential benefits in consequence of which they have been forced to return the amount of the benefits to the bankrupt estate. Many of these were decided prior to the broadening effect upon this subject of the 1938 amendments.

In Walker vs. Wilkinson, 3 F. (2) 867 at 871 (5th C. C. A.-1925) it was said in a suit by the Trustee against a guarantor:

> "* * * The appellant, the President of the bankrupt and the surety or guarantor of its liabilities to the bank, with knowledge of its insolvency, within four months prior to the filing of the bankruptcy petition, brought about the payment of $32,500.00 on liabilities of the bankrupt to the bank, whereby he was benefited in the amount of such payment; he at that time having reasonable cause to believe that such payment would effect a preference. A result was that a preference arose, the amount of which was recoverable from the appellant by the appellee, the trustee in bankruptcy * * *" (And the Court in this case allowed interest on the recovery.)

And In Re: Schleicher Printing Corporation, 62 F. (2) 503 (1933-2nd CCA) it was said at page 504:

> "* * * From the language used it is clear that the person receiving it need not be the one to be 'benefited thereby', and equally clear since the amendment of 1910, that, if the one to be benefited has reasonable cause to believe that a preference will be effected the transfer is voidable. * * * It should be noted, that in

Paper et al. vs. Stern, supra, the transfer was held voidable even though the guarantor did not induce the payment of the debt. * * *."

See also:

Swarts vs. Siegel, 117 F. 1, 13 (8th CCA);
Goldman vs. Cohen, 261 F. 672 (1st C.C.A.-1919);
Colliers 14th Edition of the Work on Bankruptcy, Vol. 3, p. 811, Sec. 60.17.

It has therefore been uniformly held that a guarantor or endorser receives a voidable preference on the occasion when the bankrupt's indebtedness so guaranteed or endorsed, is reduced or discharged.

And that this result must be reached even though the guarantor or surety neither induced the payment or discharge nor knew thereof.

In the cause at bar it is equally evident that the Guarantors received a preferential benefit; though of course since they were in active control of the bankrupt and now admitted to have had prior knowledge of its insolvency (or better than reasonable cause to believe that the debtor was insolvent) these Guarantors may also be said to have induced or brought about a situation, by continuing to make deposits in the Banks holding the bankrupt's indebtedness guaranteed by them, as a result of which they obtained these benefits. But as ~~interest~~ intent of the petitioners is no longer important in the law of "preferences", refer to this phase of the case only in review.

As the Guarantors were unentitled to the right of a creditor authorized to set-off under Section 68 the petitioners respectfully contend that they obtained an avoidable preference. And that, while the deposits in the Banks did not in and of themselves *constitute a parting with property or its possession* the *action of the Banks*, subse-

quently, in *setting-off those balances* gave rise to an *involuntary and indirect parting by the bankrupt* (or visited upon the bankrupt) *of an interest in property*, viz: those banks balances. It is therefore these events, and not the original deposits in Bank (which under the prior Bankruptcy Act produced the decisions in Bank vs. Lineberger, 45 Fed. (2) 522, 527 and Drugan vs. Crabtree, 299 Fed. 115, 119-120, supra), which since 1938 are to be stamped as the events giving rise to a voidable preference, viz: the involuntary or indirect parting from the bankrupt of an interest in property or the right to possession thereof.

CONCLUSION.

It is respectfully submitted that, because of the specification of errors below, the petition for the Writ of Certiorari should be granted so that the plenary actions may be tried.

NATHAN PATZ,
Attorney for Petitioners,
Baltimore Trust Building,
Baltimore 2, Maryland.

March 19, 1948.